No. 10352

# In the United States Circuit Court of Appeals for the Ninth Circuit

HELM AND SMITH SYNDICATE, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

*ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES BOARD OF TAX APPEALS*

## BRIEF FOR THE RESPONDENT


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## CITATIONS

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OPINION BELOW

The only previous opinion in this case is the memorandum opinion of the United States Board of Tax Appeals (R. 18–21), which is not reported.

JURISDICTION

The petition for review involves federal income and excess profits taxes for the calendar year 1938 in the amounts of $5,223.57 and $30.73, respectively. (R. 226–240.) The return in respect of which the question of tax liability arises was filed with the Collector of Internal Revenue at Los Angeles, California. (R. 196.) On February 6, 1941, the Commissioner mailed to taxpayer a notice of deficiency in the total amount

No assignment of any beneficial interest was to be valid unless the trustee should receive a duly executed original of such assignment accepted by the assignee and disclosing on his part an assumption of the obligations of the beneficiary whose interest was assigned. (R. 60.) The trustee was to continue in office until his death, resignation or removal by a final order of the court, and in case of a vacancy in the trusteeship a successor was to be elected by a majority vote of the beneficiaries of the trust. (R. 19, 61.)

The trust was to continue for a period of 25 years unless sooner terminated by an agreement of two-thirds of the beneficiaries. (R. 62.)

In 1938 Helm executed agricultural leases on part of the property, and in May of that year he negotiated oil leases with five oil companies. Terms were tentatively agreed upon and the agreements, executed by Helm as an individual, were deposited in escrow. Upon discovering that Helm held title as trustee to the property under the trust declaration, the escrow company refused to consummate the transaction until the matter of the trust was cleared up. Rather than have the leasing agreements reexecuted by Helm as trustee, the beneficiaries agreed that for the purpose of consummating the leasing agreements the trust declaration should be revoked so as to avoid Helm's having to perform the usual formalities required of a trustee. The trust declaration was therefore revoked on May 24, 1938. (R. 19, 26–27, 219.) The leases with the oil companies were then finally executed and the leasing bonuses paid. Certain of the property was sold in July, 1938. (R. 19.)

In July, 1938, a second trust instrument was executed by the parties substantially restating the terms of the earlier instrument which had been revoked. This second trust instrument specifically declared that the original declaration of trust had been revoked by the beneficiaries in full reliance upon the integrity of L. G. Helm simply for the purpose of enabling him to execute the oil leases without the necessity of complicated proceedings, which would have been required had the trust remained in existence. (R. 181.)

One of the participants sold one-fourth of his interest to each of two new persons and their proportionate interests were then recognized. In the taxable year Helm distributed the net gain and income among the participants proportionately. No explorations had been made or wells drilled upon the property. (R. 19.) The Commissioner determined that taxpayer was an association within the meaning of Section 901 (a) of the Revenue Act of 1938 and was therefore taxable as a corporation. This determination was upheld by the Board of Tax Appeals.

## SUMMARY OF ARGUMENT

The trust in this case is an association to be taxed as a corporation because it was created and maintained by associates as a medium for the conduct of a joint business enterprise and the sharing of profits therefrom. Here the associates agreed among themselves to purchase certain property, believing that it had possibilities for producing oil. Under the declaration of trust entered into between the parties, the named trustee was to manage and control the

property, and given authority to sell, encumber or lease it, including the power to execute oil and gas leases. Crop sharing and oil and gas leases were executed by him and certain of the property sold—the proceeds being distributed among the participants.

Furthermore, the trust set up to conduct business for the benefit of the beneficiaries had those features making it sufficiently analogous to a corporation and distinguishable from a partnership to justify taxing it as a corporation. The term "association" as used in the Act merely implies resemblance to, and not identity with, a corporation. That resemblance was sufficiently present in the instant case in that there was provision for holding title to the trust property continuously, centralized management, continuity of the enterprise in spite of the death of the owners of the beneficial interests, transferability of beneficial interests without affecting the continuity of the enterprise, and limitation of personal liability of the participants to the property embarked in the undertaking.

## ARGUMENT

**Taxpayer is an "association" within the meaning of Section 901 (a) of the Revenue Act of 1938 and is, therefore, taxable as a corporation**

Section 901 (a) of the Revenue Act of 1938 (Appendix, *infra*) provides that the term "corporation" as used in the Act includes "associations," while the term "partnership" includes a syndicate, pool, joint venture, or other incorporated organization, by means of which business is carried on, and which is not, within the meaning of the Act, a trust, estate or a

corporation. In examining the Congressional intent as to the meaning of the word "association" as used in the Act, the Supreme Court in *Morrissey* v. *Commissioner,* 296 U. S. 344, said (pp. 356–357):

> "Association" implies associates. It implies the entering into a joint enterprise, and, as the applicable regulation imports, an enterprise for the transaction of business. This is not the characteristic of an ordinary trust—whether created by will, deed, or declaration—by which particular property is conveyed to a trustee or is to be held by the settlor, on specified trusts, for the benefit of named or described persons. Such beneficiaries do not ordinarily, and as mere *cestuis que trustent,* plan a common effort or enter into a combination for the conduct of a business enterprise. Undoubtedly the terms of an association may make the taking or acquiring of shares or interests sufficient to constitute participation, and may leave the management, or even control of the enterprise, to designated persons. But the nature and purpose of the cooperative undertaking will differentiate it from an ordinary trust. In what are called "business trusts" the object is not to hold and conserve particular property, with incidental powers, as in the traditional type of trusts, but to provide a medium for the conduct of a business and sharing its gains. Thus a trust may be created as a convenient method by which persons become associated for dealings in real estate, the development of tracts of land, the construction of improvements, and the purchase, management and sale of proper-

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> ties; or for dealings in securities or other personal property; or for the production, or manufacture, and sale of commodities; or for commerce, or other sorts of business; where those who become beneficially interested, either by joining in the plan at the outset, or by later participation according to the terms of the arrangement, seek to share the advantages of a union of their interests in the common enterprise.

Since the *Morrissey* decision it is clear that whether a particular form of business enterprise is to be classed and taxed as an "association" does not depend upon its having a statutory organization or privilege or upon its use of corporate forms or procedure. As was said in *Fidelity-Bankers Trust Co.* v. *Helvering,* 113 F. 2d 14, 17 (App. D. C.):

> Taxability as an association or corporation no longer turns on technical differences in organizational structure nor on the degree of control given to beneficiaries in management of trust affairs. Simulation by unincorporated organizations of corporate forms and approximation of corporate advantages by skillful use of trust and contract devices have brought legislative classification with technical corporations for taxation and other purposes, * * *.

Hence, while the income of the taxpayer here is subject to the corporate tax if its business was conducted in a manner resembling that of a corporation, it is not necessary that there be complete identity of the taxpayer organization with that of a corporation. See *Commissioner* v. *Vandegrift R. & Inv. Co.,* 82 F. 2d

387, 390 (C. C. A. 9th). As the Supreme Court in the *Morrissey* case declared (pp. 357–358):

> 4. The inclusion of associations with corporations implies resemblance; but it is resemblance and not identity. The resemblance points to features distinguishing associations from partnerships as well as from ordinary trusts. As we have seen, the classification cannot be said to require organization under a statute, or with statutory privileges. The term embraces associations as they may exist at common law. * * * While the use of corporate forms may furnish persuasive evidence of the existence of an association, the absence of particular forms, or of the usual terminology of corporations, cannot be regarded as decisive.

The Court then proceeded to point out (p. 354) the salient features of a trust—when created and maintained as a medium for the carrying on of a business enterprise and sharing its gains—which may be regarded as making it analogous to a corporate organization. These features are five in number and may be summarized as follows: (1) The holding of title to the trust property by the trustees, as a continuing body with provision for succession; (2) centralized management by the trustees; (3) continuity of the enterprise carried on by means of the trust in spite of the death of owners of beneficial interests; (4) transferability of beneficial interests without affecting continuity of the enterprise and permitting the introduction of large numbers of participants; and (5) limitation of personal liability of participants to the property embarked in the undertaking.

The Court then held that the trust there in question, created for the development of a tract of land, constituted an association. See also *Swanson* v. *Commissioner,* 296 U. S. 362; *Helvering* v. *Combs,* 296 U. S. 365; *Helvering* v. *Coleman-Gilbert,* 296 U. S. 369.

There can be no question that the trust involved in the instant case comes within the general definition of an association as laid down in the *Morrissey* case. The requirements of that definition, namely, that there be associates and that they enter into a joint enterprise for the transaction of business and sharing of its gains, are fully met. Here a group of individuals agreed among themselves to purchase a certain tract of land, believing that it had possibilities for producing oil. Subsequently, a declaration of trust was prepared and entered into by all the contributors. Under that trust instrument one L. G. Helm was named trustee to hold legal title for the benefit of the named beneficiaries who had contributed to the purchase price. The trustee was to manage and control the property, and was empowered to sell, convey, encumber or lease it, including the execution of oil and gas leases, and all income and profit from the property were to be distributed to the named beneficiaries. (R. 58–59.) Various crop-sharing and oil leases were executed and certain of the property was sold and the income distributed among the beneficiaries proportionately. Clearly then, this is a case of associates entering into a joint enterprise for the transaction of business and the sharing of its gains, with the associates seeking "to share the advantages of a union of their interests in the common enterprise."

*Morrissey* v. *Commissioner, supra,* p. 357. See also *Kettleman Hills R. S. No. 1* v. *Commissioner,* 116 F. 2d 382 (C. C. A. 9th), certiorari denied, 313 U. S. 582; *United States* v. *Trust No. B. I. 35, Etc.,* 107 F. 2d 22 (C. C. A. 9th); *Title Insurance & Trust Co.* v. *Commissioner,* 110 F. 2d 482 (C. C. A. 9th); *Thrush Lease Trust* v. *Commissioner,* 99 F. 2d 925 (C. C. A. 9th), certiorari denied, 306 U. S. 654; *Monrovia Oil Co.* v. *Commissioner,* 83 F. 2d 417 (C. C. A. 9th); *Commissioner* v. *Vandegrift R. & Inv. Co., supra; Nashville Trust Co.* v. *Cotros,* 120 F. 2d 157, 122 F. 2d 326 (C. C. A. 6th), certiorari denied, 314 U. S. 680; *Sibley Syndicate* v. *Commissioner,* 131 F. 2d 224 (C. C. A. 6th), certiorari applied for March 12, 1943.

The trust in the instant case, which thus satisfies the primary conception of an association, has in addition, we submit, those features which point to resemblance to a corporation as distinguished from a partnership. The first feature—the holding of title to the trust property by the trustee, as a continuing body with provision for succession—is expressly provided for by the appointment of a trustee to hold title to the property (R. 58) and by providing that such trustee shall continue in his office until death or resignation, and in case of vacancy in the trusteeship, a new trustee shall be appointed by the beneficiaries of the trust (R. 61). The second feature—centralized management—is also expressly provided for by the appointment of a trustee and the powers given him to manage and control the trust property. (R. 58.)

The third feature—continuity of the enterprise in spite of the death of the owners of the beneficial interests—was secured by virtue of the use of the trust form. It seems clear that the beneficiaries here had no interest in the trust property itself, but only rights to the performance of the trust, to the distribution of the profits, and to the distribution of the property remaining at the termination of the trust. (R. 57–59, 63.)

The assertion of taxpayer to the effect that the trustee was merely an agent of the beneficiaries and that his death would have interrupted the continuity of the enterprise (Br. 19–20) finds, we submit, no support in the facts. The trustee here was expressly designated as a trustee; he was never referred to as an agent. Title to the property was vested in the trustee for the benefit of the participants and he was given the power to manage and control the trust property. In *Taylor* v. *Davis,* 110 U. S. 330, the Supreme Court said (pp. 334–335):

> A trustee is not an agent. An agent represents and acts for his principal, who may be either a natural or artificial person. A trustee may be defined generally as a person in whom some estate, interest, or power in or affecting property is vested for the benefit of another.

See also *Sibley Syndicate* v. *Commissioner, supra; Commissioner* v. *Fortney Oil Co., Etc.,* 125 F. 2d 995 (C. C. A. 6th); *Nashville Trust Co.* v. *Cotros, supra.* Since L. G. Helm was clearly a trustee, and not an agent, taxpayer's reference (Br. 19) to the provisions of the California Civil Code, dealing with the termina-

tion of an agency, can obviously have no pertinency here.

Nor is taxpayer's position aided by his contention that the death of any of the participants would have interrupted the continuity of the enterprise. While such a result might follow under the state law *if* the organization were in reality a partnership,[1] the fact that such enterprise is carried on by means of a trust secures it from interruption by the death of owners of beneficial interests, and it is in this respect that such interests are distinguished from those of partners and are akin to the interests of members of a corporation. *Morrissey* v. *Commissioner, supra,* p. 358. In fact, in California itself, it has been recognized that wherever several persons transfer legal title in property to trustees with complete power of management, the trustees to pay over the profits of the enterprise to the creators, a business trust is formed which, unlike a partnership, does not dissolve upon the transfer of any interest or upon the death of any participant. *Goldwater* v. *Oltman,* 210 Cal. 408, 292 Pac. 624.[2]

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[1] Even if the enterprise engaged in here were held under the state law to create the relationship of principal and agent, such holding would not control the status of the enterprise for purposes of determining its taxability as an association under the federal statute. *Commissioner* v. *Fortney Oil Co., Etc., supra,* p. 997.

[2] Section 2280 of the California Civil Code relied upon by taxpayer (Br. 25) and which provides that voluntary trusts are revocable unless expressly made irrevocable does not militate against the conclusion that taxpayer is taxable as an association. Apart from the fact that it is doubtful whether that section has any application to other than a pure trust, and not to a business trust as is involved in the instant case, taxpayer's argument would

The fourth feature indicating resemblance to a corporation—transferability of beneficial interests without effecting continuity of the enterprise—is also present in the instant case, despite taxpayer's claim to the contrary. That the assignability of the beneficial interests or any part thereof was contemplated is made clear by that provision of the trust instrument expressly requiring that the trustee be notified of any such assignment and that the assignee assume the obligation of the participants as to the interest so assigned. (R. 60.)[3] Nor does taxpayer seriously dispute this proposition. Taxpayer relies, however, upon the fact that the interests of the participants were not evidenced by any tangible certificates, or other indicia of ownership. While it is true that in the *Morrissey* case there was a provision in the trust for the issue of transferable certificates, that fact was considered as simply carrying "the analogy to corporate organization * * * still further." (P. 360.) As the Supreme Court there declared (p. 358):

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mean that no business trust created in California could be taxed as an association unless expressly made irrevocable. Such result was obviously never intended by the federal taxing statute. See *Morrissey* v. *Commissioner*, *supra; Kettleman Hills R. S. No. 1* v. *Commissioner*, *supra; United States* v. *Trust No. B. I. 35, Etc.*, *supra; Title Insurance & Trust Co.* v. *Commissioner*, *supra; Monrovia Oil Co.* v. *Commissioner*, *supra; Commissioner* v. *Vandegrift R. & Inv. Co.*, *supra.*

[3] Even the lack of a specific provision permitting the transfer of beneficial interests has been held not to compel the conclusion that a transfer of beneficial interests could not be made without affecting continuity of the enterprise. *Nashville Trust Co.* v. *Cotros*, *supra; Del Mar Addition* v. *Commissioner*, *supra; Sibley Syndicate* v. *Commissioner*, *supra.*

> Again, while the faculty of transferring the interests of members without affecting the continuity of the enterprise may be deemed to be characteristic, the test of an association is not to be found in the mere formal evidence of interests or in a particular method of transfer.

Thus it has been expressly held that the issuance of certificates of beneficial interests or other indicia of ownership is not an essential requirement for taxability of a business enterprise as an association. *Monrovia Oil Co.* v. *Commissioner; Nashville Trust Co.* v. *Cotros, supra; Del Mar Addition* v. *Commissioner,* 113 F. 2d 410 (C. C. A. 5th); *Commissioner* v. *Fortney Oil Co., Etc., supra; Sibley Syndicate* v. *Commissioner; Commissioner* v. *Nebo Oil Co., Trust,* 126 F. 2d 148 (C. C. A. 10th), certiorari denied October 12, 1942. See also *Helvering* v. *Coleman-Gilbert, supra.*

The fifth and last feature pointing to resemblance to a corporation—limitation of personal liability of the participants to the property embarked in the undertaking—taxpayer insists is not present in the instant case. It is taxpayer's contention that the participants agreed to be personally liable for all the obligations incurred by the trustee in the performance of his duties. In support of this contention taxpayer relies upon the provision of the trust instrument which provided that each of the participants should contribute his proportion of the funds necessary to pay any encumbrances placed upon the property, including taxes and assessments. (R. 58–59.) But, we submit, that provision is a far cry from an assumption of unlimited

personal liability by the beneficiaries. The purpose of that provision obviously was to protect the trust property by requiring the participants, if necessary, to contribute a pro rata share sufficient to relieve it of any encumbrances, such as taxes or assessments. It may be true that if the participants failed to contribute enough to discharge any encumbrance on the trust property, the property might be lost. But this is not to say that the beneficiaries were personally liable to creditors for the payment of all debts and obligations incurred by the trustee in the performance of his duties. On the contrary, the provision seems to recognize that the personal liability of the participants was limited to the trust property.[4] Furthermore, even if the provision relied upon is interpreted as imposing personal liability on the participants, such liability, rather than being unlimited, was expressly limited to each participant's proportionate share of any encumbrance. In any event, the courts have recognized that a provision limiting the liability of beneficiaries is not a *sine qua non* of taxability of a business enterprise as an association. At the most, as this Court and others have pointed out, the purpose to limit the liabilities of the participants indicates merely a "further resemblance to a corporation." *Thrash Lease Trust* v. *Commissioner, supra,* p. 928.

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[4] The trust agreement provided that if any beneficiary failed to pay his proportionate share of sums expended by the trustee upon any encumbrances placed on the property, the trustee was to advance the necessary sum and if not repaid by the defaulting beneficiary, such beneficiary's interest was to be sold. The beneficiary was to receive any excess of the selling price over the amount owed by him. (R. 59–60.)

See also *Del Mar Addition* v. *Commissioner, supra,* p. 411; *Nashville Trust Co.* v. *Cotros, supra,* p. 159; *Kilgallon* v. *Commissioner,* 96 F. 2d 337, 338 (C. C. A. 7th), certiorari denied, 305 U. S. 622; *Bert* v. *Helvering,* 92 F. 2d 491 (App. D. C.).[5] As the Court of Appeals said in the last mentioned case (p. 495):

> While, therefore, it is true that the Supreme Court in all four cases in 296 U. S. mentions limitation of liability as one of the characteristics of the trusts declared in those cases to be associations under the law, and while in this case the right of the beneficiaries or the trustee to limitation of liability may perhaps be challenged, as to which we need express no opinion, we think this is not the vital and conclusive factor under the terms of the tax act, or that the Supreme Court intended in its four opinions to make it an indispensable element in cases of this sort. * * * We think, as was said in *Commissioner v. Brouillard* (C. C. A.) 70 F. (2d) 154, that where an entity of this kind resembles a corporation in some respects and a partnership in others, the features of similarity should be compared and the marks of dissimilarity contracted. The resemblances should be balanced. It should be determined by that test the one to which the enterprise is predominantly akin in the method, mode, and form of procedure in the conduct of its business. This is what we think the Supreme Court meant when it said in the *Morrissey* case, "The inclusion of

[5] In *Helvering* v. *Combs, supra,* an examination of the record fails to disclose any express limitation of liability of the beneficiary, although the court speaks of it in its opinion.

associations with corporations implies resemblance; but it is resemblance and not identity."

The Government's contention that taxpayer here is taxable as an association finds further support in the applicable Treasury Regulations. The Supreme Court in the *Morrissey* case declared (pp. 354–355):

> As the statute merely provided that the term "corporation" should include "associations," without further definition, the Treasury Department was authorized to supply rules for the enforcement of the Act within the permissible bounds of administrative construction.

An examination of Treasury Regulations 101, Articles 901–1 and 901–4 (Appendix, *infra*), dealing with the meaning of the term "association" generally and as distinguished from a trust, and with the term "partnership," makes it readily apparent that the trust in the case at bar comes clearly within the definition of "association."

Thus Article 901–2 (Appendix, *infra*) provides, with regard to associations, that the term "association" is not used in the Act in any narrow technical sense, but includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group acting in a representative capacity.

Article 901–3 (Appendix, *infra*) distinguishes from an ordinary trust, an arrangement, as in the instant case, whereby legal title to property is conveyed to a

trustee who, under a declaration of trust, holds and manages the property with a view to income or profit for the benefit of the beneficiaries. Such an arrangement is designed to afford a medium whereby profit-seeking activity may be carried on through a substitute for an organization such as a voluntary association or joint stock company or a corporation, with the beneficiaries supplying the capital and the trustee acting as manager of the undertaking. The article points out that by means of such a trust the disadvantages of an ordinary partnership are avoided, and many of the advantages characteristic of a corporation obtained, and that the Act therefore treats such a trust according to its essential nature, namely, as an association.

And with regard to partnerships, Article 901–4 states that the Act provides its own concept of a partnership including therein not only a partnership as known at common law, but, as well, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any business, financial operation, or venture, and which is not, within the meaning of the Act, a trust, estate, or a corporation. The article further provides that, on the other hand, the Act classifies under the term "corporation" an association or joint stock company, the members of which may be subject to the personal liability of partners, and that, if an organization is not interrupted by the death of a member or by a change in ownership of a participating interest during the agreed period of existence, and its management is centralized in one or more persons in their representative capacities,

such an organization is an association, taxable as a corporation.

The cases cited and relied upon by taxpayer here do not, we submit, support its contention that it is not taxable as an association. Each case must, of course, necessarily depend upon its own facts. As the Supreme Court in the *Morrissey* case (p. 356) pointed out, it was impossible in the nature of things to translate the statutory concept of "association" into a particularity of detail that would fix the status of every sort of enterprise or organization which ingenuity may create. Thus *Commissioner* v. *Gerstle,* 95 F. 2d 587 (C. C. A. 9th), and *Commisioner* v. *Rector & Davidson,* 111 F. 2d 332 (C. C. A. 5th), certiorari denied, 311 U. S. 672, upon which taxpayer relies, are readily distinguishable. At the outset it should be observed that in each of those cases the appellate court refused to reverse the holding of the Board of Tax Appeals that the enterprises in question were not taxable as associations. The refusal in each instance seems to be based upon the ground that while the arrangements had some of the attributes of a corporation, the Board's finding that they more nearly resembled joint ventures was reasonable in light of the evidence. As the court said in the *Rector & Davidson* case (p. 333):

> * * * the finding of the Board of Tax Appeals that respondent was a syndicate or joint venture which resembled a partnership more nearly than it did a corporation was a fair and reasonable conclusion, supported by the evidence, and its decision should be affirmed.

In the *Gerstle* case it was felt that the members of the syndicates were equitable owners of the real property and that their beneficial interests were not mere personal claims against the syndicate managers. In the case at bar it seems clear that the beneficial interests were not interests in the property but rights to the performance of the trust and distribution of the net profits and of the property remaining at the termination of the trust. Also in the *Gerstle* case the syndicate agreements expressly provided that the syndicate managers were to act as agents as well as trustees for the members. No comparable provision appears in the instant case. Furthermore, in the *Gerstle* case no assignment by any member was to release him from his liability unless the syndicate managers so agreed. And finally, the liability of the participants in that case was not limited. As previously pointed out, such does not appear to have been the situation here.

The *Rector-Davidson* case is likewise distinguishable in that there no trust was ever created. The managers of the property were expressly designated as the agents and attorneys in fact of the participants. Title to the property was held in undivided interests by all of the participants, as tenants in common. The instant case is obviously dissimilar. More nearly like the instant case are, we submit, *Thrash Lease Trust* v. *Commissioner, supra; Del Mar Addition* v. *Commissioner, supra; Nashville Trust Co.* v. *Cotros, supra; Sibley Syndicate* v. *Commissioner, supra; Commissioner* v. *Fortney Oil Co., Etc., supra.* See also *Commissioner*

v. *Vandegrift R. & Inv. Co., supra; Monrovia Oil Co.* v. *Commissioner, supra.*[6]

It seems necessary to deal briefly with taxpayer's argument that the trust agreement entered into by the various participants should be ignored in determining whether the enterprise is taxable as an association. It should be noted that in May of 1938, L. G. Helm negotiated oil leases with five oil companies. Terms were tentatively agreed upon and the agreements executed by Helm as an individual were deposited in escrow. When the escrow company found that Helm held title under the original trust declaration entered into on June 29, 1937, it refused to consummate the transaction until the trust matter was cleared up. So rather than have the leasing agreements re-executed by Helm as trustee, the beneficiaries agreed that for the purpose of consummating the leasing agreements, the trust declaration should be revoked so as to avoid Helm's having to perform the usual formalities required of a trustee. Such revocation was made on May 24, 1938. (R. 26–27, 219.) The leases with the oil companies were then finally executed and the leasing bonuses paid. Thereafter on July 15, 1938, a second trust declaration, virtually identical with the original trust instrument, was executed. It is the taxpayer's contention that because

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[6] *Commissioner* v. *Gibbs-Preyer Trusts Nos. 1 & 2*, 117 F. 2d 619 (C. C. A. 6th), cited by taxpayer, also involved the affirmance of the Board's decision by the reviewing court. That case turned on the fact (p. 623) that the trusts in question were not created and maintained as mediums for the carrying on of business enterprises and sharing in their gains. Obviously no such contention can be made in the instant case.

the leasing bonuses were received in the interim while no formal trust declaration was in effect, the question of whether taxpayer is taxable as an association must be decided without any consideration of the trust agreements. Apart from the fact that substantial portions of the income in question were received by the taxpayer while the trust declarations were in effect,[7] it seems manifest that taxpayer's contention cannot be sustained. By taxpayer's own admission, the revocation of the original trust instrument was effected simply as a temporary measure designed to avoid the usual formalities required of a trustee. It was clearly contemplated by all the parties that the true relationship between the participants was not to be affected in any way by the revocation of the original trust declaration, and that as soon as the leasing agreements were consummated, the trust agreement would be immediately restored. In fact, the second declaration of trust, executed on July 15, 1938, specifically declares that the original trust instrument was revoked by the beneficiaries in full reliance upon the integrity of L. G. Helm, simply for the purpose of enabling him to execute the oil leases without the necessity of complicated proceed-

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[7] Taxpayer's assertion (Br. 25) that the income in question was realized when no trust declaration was in effect is not in accord with the facts. While certain of the property was sold for a price of $10,806.25 on June 29, 1938, during the interim when there was no formal trust declaration, other property was sold for $7,800 on July 25, 1938, *after* the second trust declaration had been executed. (R. 204.) Furthermore, receipts totaling some $3,851.08 were obtained from crop-sharing leases *prior* to the revocation of the original trust declaration. (R. 201.)

ings. (R. 181.) To seize upon the technicality of the lack of a formal trust instrument for a short interval as a basis for avoiding taxability as an association is so obviously to subordinate substance to form as to require no further comment. Contrary to the assertion of taxpayer (Br. 25) that only "by virtue of some fiction [may] it [be] * * * argued that the characteristics of the organization were at all times governed by the trust agreement," we think it clear that it is only by virtue of some fiction that it can be argued otherwise.[8]

## CONCLUSION

The decision of the Board of Tax Appeals is correct and should be affirmed.

Respectfully submitted,

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April, 1943.

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[8] In any event, it seems manifest that during the interval while no formal trust was in existence, a resulting trust in fact existed. See *Nashville Trust Co.* v. *Cotros*, *supra*, p. 159. See also *Swanson* v. *Commissioner*, *supra;* 1 Scott, Law of Trusts (1939) c. 2, Sec. 17.4, p. 142; 3 Scott, Law of Trusts (1939) c. 12, Sec. 440.1, p. 2242.

# APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 52. CORPORATION RETURNS.

Every corporation subject to taxation under this title shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title and such other information for the purpose of carrying out the provisions of this title as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

SEC. 901. DEFINITIONS.

(a) When used in this Act—

* * * * *

(2) The term "corporation" includes associations, joint-stock companies, and insurance companies.

(3) The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within

the meaning of this Act, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

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Treasury Regulations 101, promulgated under the Revenue Act of 1938:

ART. 901–1. *Classification of taxables.*—For the purpose of taxation the Act makes its own classification and prescribes its own standards of classification. Local law is of no importance in this connection. Thus a trust may be classed as a trust or as an association (and, therefore, as a corporation), depending upon its nature or its activities. (See article 901–3.) The term "partnership" is not limited to the common law meaning of partnership, but is broader in its scope and includes groups not commonly called partnerships. (See article 901–4.) The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, an insurance company, and certain kinds of partnerships. (See articles 901–2 and 901–4.) The definitions, terms, and classifications, as set forth in section 901, shall have the same respective meaning and scope in these regulations.

ART. 901–2. *Association.*—The term "association" is not used in the Act in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a decla-

ration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which it not, within the meaning of the Act, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.

ART. 901–3. *Association distinguished from trust.*—The term "trust," as used in the Act, refers to an ordinary trust, namely, one created by will or by declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for an organization such as a voluntary associa-

tion or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages. The nature and purpose of a cooperative undertaking will differentiate it from an ordinary trust. The purpose will not be considered narrower than that which is formally set forth in the instrument under which the activities of the trust are conducted.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Act as a corporation. However, the fact that the capital or property of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association.

By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corpora-

tion, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form *itself*. The Act disregards the technical distinction between a trust agreement (or declaration) and ordinary articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely, as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.

Art. 901–4. *Partnerships.*—The Act provides its own concept of a partnership. Under the

term "partnership" it includes not only a partnership as known at common law but, as well, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any business, financial operation, or venture, and which is not, within the meaning of the Act, a trust, estate, or a corporation. On the other hand the Act classifies under the term "corporation" an association or joint-stock company, the members of which may be subject to the personal liability of partners. If an organization is not interrupted by the death of a member or by a change in ownership of a participating interest during the agree period of its existence, and its management is centralized in one or more persons in their representative capacities, such an organization is an association, taxable as a corporation. As to the characteristics of an association, see also articles 901–2 and 901–3. The following examples will illustrate some phases of these distinctions:

(1) If A and B buy some acreage for the purpose of subdivision, they are joint adventurers, and the joint venture is classified by the Act as a partnership.

(2) A, B, and C contribute $10,000 each for the purpose of buying and selling real estate. If A, B, C, or D, an outside party (or any combination of them as long as the approval of each participant is not required for syndicate action), takes control of the money, property and business of the enterprise, and the syndicate is not terminated on the death of any of the participants, the syndicate is classified as an association.

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